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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

REBUTTAL COMMENTS OF CANADIAN NATIONAL RAILWAY COMPANY

Sean Finn
Senior Vice-President Public Affairs,
Chief Legal Officer and Corporate Secretary
CANADIAN NATIONAL RAILWAY COMPANY
P.O. Box 8100
Montréal, PQ H3B 2M9
(514) 399-6500

Paul A. Cunningham
David A. Hirsh
James M. Guinivan
HARKINS CUNNINGHAM LLP
1700 K Street, N.W., Suite 400
Washington, DC 20006-3804
(202) 973-7600

Theodore K. Kalick
CANADIAN NATIONAL RAILWAY COMPANY
Suite 500, North Building
601 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 347-7840

Counsel for Canadian National Railway Company

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Canadian National Railway Company (and its U.S. rail carrier subsidiaries) (collectively, "CN") hereby submits its rebuttal comments in this proceeding. CN addresses arguments made in reply that are related to the two issues discussed in CN's opening comments: (1) the possible application of the proposed rules to U.S.-Canada through rates; and (2) movement-specific adjustments to URCS system-average costs. In addition, CN asks the Board to continue efforts to assure that methodologies for simplified and expedited challenges to the reasonableness of rail rates are as accurate as possible and comport with the fundamental principles of constrained market pricing ("CMP").[1]

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[1] CN again joins in the comments filed on behalf of the railroad industry by the Association of American Railroads ("AAR").

I. CROSS-BORDER TRAFFIC

CN explained in its opening comments that the Board may be unable to apply its proposed rules in their current form to U.S.-Canada cross-border movements because Uniform Rail Costing System ("URCS") data and complete Carload Waybill Sample data are not available for the portions of such movements in Canada, and the Board's proposals would rely on such data. Canadian Pacific Railway Company made much the same argument in its opening comments (at 4-7). CN asked that if the Board adopts rules for small or medium size cases that would require URCS or waybill sample information, the Board recognize these data problems in its decision and provide for the necessary substantive and procedural flexibility to address these issues if and when there is a challenge to a transborder U.S.-Canada through rate.

The only party to address this issue in reply was The Kansas City Southern Railway Company ("KCS"). KCS Reply Comments at 15-16. KCS argues that a lack of URCS and Waybill Sample data for the Mexican portion of cross-border movements raises the same problem concerning the application of the Board's proposed rules to cross-border U.S.-Mexico traffic as CN and CP identified regarding cross-border U.S.-Canada traffic. KCS suggests (at 16) that the Board consider whether it should hold its rules in abeyance in order to resolve this issue.

CN does not believe it is necessary or appropriate for the Board to hold its rules in abeyance or to address these data issues now. There is no need to delay the application of the Board's rules to the large majority of all traffic, which is domestic, in order to address a potential issue regarding the much smaller volume of international cross-border international traffic. Further, CN believes the Board can best understand and address

these issues if and when it is presented with an actual cross-border rate reasonableness challenge, and that it can also conserve its own resources and those of various parties by waiting to see if a small or medium-sized cross-border rate case is actually filed and there is a need to address the data problem.

II. MOVEMENT-SPECIFIC ADJUSTMENTS TO URCS SYSTEM AVERAGE COSTS

CN explained in its opening comments that it is both critical and practical for the Board to permit certain movement-specific adjustments to URCS system average costs for each of its proposed methodologies. CN Opening Comments at 4-6. Similar views were expressed by many other parties in their opening and reply comments.[2] In their reply comments (at 25-32), the American Chemistry Council et al. ("Joint Shippers") argue against any such adjustments by presenting the Board with a false choice between simplification and reasonable accuracy.

Before directly addressing what the Joint Shippers say, it is important to note what they do not say. They cannot and do not maintain that URCS system average costs account for all of the actual variable costs of a movement. In fact, the railroads have identified, and it is well understood, that there are a number of variable costs that are not accounted for at all using URCS system averages, and that there are others that would be grossly underestimated. Further, the shippers cannot and do not argue that the level of such additional or grossly understated costs can be categorically dismissed as insubstantial in every potential rate case. To the contrary, an array of significant costs

[2] See, e.g., CSX/NS Opening Comments at 16-22; BNSF Opening Comments at 11-12; CP Opening comments at 12-15, 18; AAR Opening Comments at 14; AAR Reply Comments at 16-18; Snavely King Majoros O'Connor & Lee, Inc. Reply Comments at 7.

may be ignored or grossly understated by system average URCS in any one case, resulting in an extremely inaccurate estimate of actual variable costs.

For example, there is wide range of additional costs that may apply to hazmat movements, particularly toxic inhalation hazards ("TIH") (see CN Opening Comments at 5), which individually or together can easily represent a large share of the total actual cost of such movements. These costs include STB-prescribed mileage payments for the use of specialized, privately-owned tank cars, added insurance premiums, added safety and training costs, costs due to speed restrictions imposed for hazmat traffic, including increased crew costs as well as increased equipment costs due to reduced asset utilization for cars and locomotives, additional yard costs for extra switching and marshalling due to special blocking requirements for hazmat, additional derailment clean up costs, additional training costs for personnel, and additional time and expense to assure that all movement documentation is correct. Moreover, it is anticipated that additional costs will be imposed in the future on the railroads through new rules and restrictions likely to be adopted by the Department of Homeland Security and other agencies concerned with security and safety. Indeed, requirements for new or additional security, inspection, monitoring, tracing, reporting, and routing restrictions for TIH traffic are all presently under consideration,[3] and the extension of similar restrictions for other hazmat movements may soon follow.

CN is concerned that if the Board adopts its proposed rules without a mechanism to account for such costs, it could well prompt numerous small and medium size rate

[3] See Hazardous Materials: Enhancing Rail Transportation Safety and Security for Hazardous Materials Shipments, 71 Fed. Reg. 76834 (proposed Dec. 21, 2006) (to be codified at 49 C.F.R. Parts 172 & 174); Rail Transportation Security, 71 Fed. Reg. 76851 (proposed Dec. 21, 2006) (to be codified at 49 C.F.R. Parts 1520 & 1580).

challenges (or threats of such challenges) directed at hazardous materials, environmentally sensitive chemicals, time-sensitive materials, and other movements that tend to be highly rated and have substantial costs that are not accounted for or that are grossly underestimated by system average URCS costing. Apart from the practical point that the Board and the industry might find itself faced with numerous rate cases based upon the equivalent of a regulatory loophole, the result would effectively be to place enormous pressure on the railroads to reduce artificially their rates for significant portions of their traffic, denying them a fair opportunity to earn adequate revenues. Such a result would violate the most basic precepts of ICCTA,[4] due process, and administrative law.[5]

The Joint Shippers ignore these issues, and implicitly urge the Board to do the same, by presenting a false choice between simplification and reasonable accuracy. They argue that some adjustments can present "complicated issues" and, in any event, if the Board dares to permit any adjustments in a case, the shippers will make the adjustment process "endless" by pressing their own "counter-theories of URCS adjustments deemed beneficial to a shipper's case." Joint Shipper Reply Comments at 31. Many of these claims concerning the complexity of issues and substantial shipper counter-theories are fanciful.[6] The Board need not allow threats of frivolous shipper claims to dictate its

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[4] ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803.

[5] CN is aware that the Board has recently prohibited adjustments to URCS system average costs in Ex Parte No. 657 (Sub-No. 1), over the objections of the AAR and others. *Major Issues in Rail Rate Cases*, slip op. at 50-61 (served Oct. 30, 2006). The importance of permitting such adjustments in this proceeding is much greater than in SAC cases, however, because the Board has proposed to use URCS not only to make an initial jurisdictional determination, but also to calculate operating and equipment expenses under simplified SAC and R/VC ratios that will be used to determine reasonable rate levels under the Three Benchmark methodology.

[6] For example, in opposing adjustments to recognize payments to third parties, the Joint Shippers appear to argue (at 29) that carriers may claim to have made such

actions in this proceeding; it has ample authority to prevent any such abuses. As for the Joint Shippers' selective examples of potentially contentious adjustments, they say nothing, of course, about other adjustments that are straightforward. For example, even the Joint Shippers concede that consideration of the added costs of STB-prescribed mileage payments for highly specialized, private tank cars would not be contentious.[7]

The Joint Shippers also try (at 30-31) to sweep aside other added costs associated with carrying hazardous materials on the ground that these costs must be "imputed" based on "varying degrees of risk." In fact, however, in addition to private car costs, many of the other additional costs for such movements identified above (for example, additional crew and equipment costs for extra switching and marshalling) are directly incurred as a result of specific hazardous materials movements.

More importantly, these and other arguments based on the supposed cost and complexity of adjustments miss the fundamental point that the Board would not have to

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payments constructively if they provide a shipper with a lower freight rate for movements in its own cars. Joint Shippers cite no example of a carrier having pressed such a claim, which, in any event, would not present the Board or the shipper with a complex issue. The Joint Shippers even try to complicate instances where a railroad directly pays a shipper for services the shipper provides related to its movement of traffic by suggesting (at 30) that it may be necessary and appropriate to open an inquiry into the sufficiency of such a payment. However, the Joint Shippers never explain how or why a shipper might benefit from arguing that it may be under-compensated by a railroad for services it provides when the reasonableness of the railroad's rate is determined by reference to the costs (which would only rise if the railroad were constructively required to pay the shipper more) and revenues of the carrier.

[7] See Joint Shippers Reply Comments at 29 ("In reality, except in those rate instances when a mileage allowance actually is paid to tank car owners pursuant to a rate prescribed in Ex Parte No. 328, it is probable that each railroad's claim of 'actual' car ownership costs for the use of private cars would be contentious . . . ."). Although the Joint Shippers suggest that the use of such cars are "rare instances," that is not true when it comes to the movement of hazardous materials such as TIH and other extremely dangerous hazardous materials (many of which are pressurized liquids). For these commodities, the use of private tank cars is the rule, rather than the exception.

address these issues afresh over and over again in individual rate proceedings. Whether the Board proceeds case-by-case or by formal or adjudicative rulemaking, the Board can address and resolve questions concerning acceptable adjustments efficiently and without overcomplicating individual rate cases. As issues become settled and the Board and parties gain experience, the time and expense required to make adjustments to URCS system average costs in the individual cases should diminish.

Initially, for example, the Board may determine to permit adjustments to URCS system average costs only for certain defined situations, such as movements of hazardous materials, high and wide shipments, or to account for payments to other railroads and third parties. With experience, the Board may determine that there are other limited instances in which it might permit adjustments to URCS system-average costs. The Board may resolve specific issues related to adjustments as they arise so they need not be relitigated in individual cases. Alternatively, or in addition, as proposed by CN in its opening comments, the Board could undertake a rulemaking to consider changes to URCS costing to incorporate additional movement-specific inputs to account for the added costs for movements such as hazardous materials.

Whatever means the Board chooses to use, if it adopts a rate reasonableness methodology such as simplified stand-alone cost ("SAC") or the three-benchmark methodology that substantially relies on accurate costing, CN urges the Board to provide an exception in appropriate circumstances to permit a party to demonstrate expeditiously that its costs are substantially higher than those generated by unadjusted URCS system average costs.

III. THE BOARD SHOULD CONTINUE ITS EFFORTS TO ASSURE THAT ITS METHODOLOGIES FOR SIMPLIFIED RATE REASONABLENESS DETERMINATIONS COMPORT WITH THE PRINCIPLES OF CONSTRAINED MARKET PRICING

CN supports the Board's efforts to establish revised simplified standards to determine the reasonableness of challenged rates where the amount at stake makes a full stand-alone cost analysis too expensive. To that end, the Board should continue efforts to assure that, to the extent practicable, rate regulation of rail traffic remains consistent with the fundamental principles of CMP and stand-alone cost. Any substantial departure from that sound economic basis for determining rate reasonableness presents a very real threat to the opportunity for the nation's railroads to achieve sustained revenue adequacy and thus to maintain and expand the nation's railroad system.

The record in this proceeding indicates that the Board's proposed simplified SAC methodology, with appropriate modifications, can provide a relatively low-cost method of determining rate reasonableness that is reliable, fair, unbiased, and reasonably consistent with the basic principles of CMP. By contrast, the Three Benchmark methodology proposed by the Board, which relies on a formulaic use of rate comparisons, departs fundamentally from the principles of CMP and is likely to produce results that substantially vary from the results that would obtain under a SAC analysis.[8] Although CN understands that the Board has adopted the Three Benchmark methodology because it believes it will be even lower cost than the simplified SAC methodology, CN believes the approach is not rooted in sound economics and that, even with the

[8] Indeed, as explained in the comments of AAR and individual rail carriers, changes proposed by the Board to existing standards for small rate cases, including its change in the calculation and role of the RSAM and $R/VC_{>180}$ benchmarks, only exacerbate these concerns.

modifications proposed by CN and other rail carriers, it sacrifices too much accuracy in the name of cost-savings and expedition.

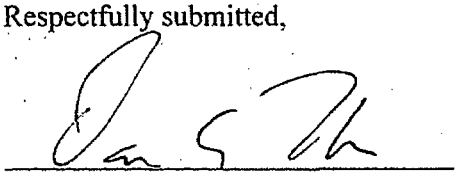
CN therefore urges the Board to apply its simplified SAC methodology, with the modifications proposed by CN and the other carriers, for any and all rate challenges where a full SAC presentation would be too costly. CN also urges the Board to continue working even after the close of this rulemaking to improve the accuracy and further reduce the costs of the simplified SAC analysis without reducing its accuracy by taking advantage of continuing developments in technology and the lessons from applying simplified SAC over time. As the Board continues to refine and reduce the costs of the simplified SAC methodology, CN believes it will become increasingly evident that a separate benchmark methodology is not required to address small rate cases.

By adhering to a rational economic model of rate regulation, the Board will best serve the public interest and the goals of the rail transportation policy, including allowing to the maximum extent possible competition and demand to establish reasonable rates, minimizing federal regulation, promoting a safe and efficient rail system by allowing rail carriers to earn adequate revenues, ensuring the development and continuation of a sound rail transportation system, and assuring that rates are reasonable in the absence of effective competition. 49 U.S.C. § 10101(1)-(6). It will also lay to rest any possible argument about its obligations under 49 U.S.C. § 10701(d) (3).[9]

[9] By completing its rulemaking in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines – Non-Coal Proceedings, the Board had met its statutory obligation under 49 U.S.C. § 10701(d) (3) even prior to this proceeding. If the Board adopts simplified SAC (with the modifications requested by CN and other carriers) in this proceeding, it will leave no doubt that the Board has met both the letter and the spirit of that provision.

Nonetheless, if the Board determines to apply its Three Benchmark methodology in some cases, it should limit the scope of that proposal as much as possible, including rejecting the proposals by a number of shipper interests to expand eligibility for use of that methodology.

Respectfully submitted,



Paul A. Cunningham
David A. Hirsh
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HARKINS CUNNINGHAM LLP
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Suite 500, North Building
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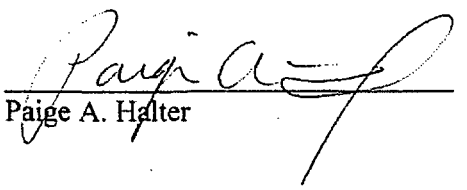
Washington, D.C. 20004
(202) 347-7840

January 11, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this 11th day of January, 2007, served the foregoing Rebuttal Comments of Canadian National Railway Company on all parties of record in this proceeding by first-class mail or a more expeditious method of delivery.



Paige A. Halter